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SUBJECT: QUARTERLY ECONOMIC REPORT

REFTEL: CAIRO 361

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SUMMARY  
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- ¶1. In this edition:
- Strong macroeconomic indicators
  - Unemployment, inflation remain high
  - The government introduces a new five year plan
  - Ministry of Finance announces bad-debt repayment plan
  - State-owned banks merge
  - Wages stagnate...
  - ...and consumer confidence dips
  - Capital Markets Law amended
  - New securitization rules
  - Draft real estate tax reductions
  - New Islamic mortgage finance company
  - Google signs agreement with GOE
  - New oil and gas investment companies
  - Cairo hosts Arab Water Conference

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MACROECONOMIC  
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¶2. Egypt ended 2006 on a strong note, registering a real growth rate of 7.1% in 4Q2006, and 6.9% for the full fiscal year 2005-2006 (June 2005 - July 31, 2006). Egypt's foreign reserves stood at \$26 billion in December 2006, and year-on-year (y-o-y) growth in exports rose 34.2% in 2006. Egypt ranked second among African countries in attracting foreign direct investment (after South Africa), reaching \$6.1 billion in FY 2005/06. Growth in credit to the private sector also exceeded growth in bank deposits for the first time since 1999. The GOE also made progress in reducing the debt of state-owned companies to LE 10 billion, down from LE 31.5 billion in 2004.

¶3. Downsides included continued unemployment, though figures vary on the actual numbers of unemployed and underemployed. The GOE claims unemployment fell to 9% in 2006, but most analysts place it closer to 11-12%, at a minimum. Inflation also continued to climb through December and January, reaching a high of 12% (y-o-y) at the end of January. In light of the average Egyptian's worries about high inflation, on February 4, President Mubarak called for government policies to curb inflation and protect low-income groups (reftel). He also asked the government to quickly approve a package of incentives to encourage investment in Upper Egypt, emphasizing the importance of securing an additional LE 20 billion (\$3.4 billion) for waste water projects in Upper Egypt and the Delta. Finally, he supported continued financial sector reform.

14. Five-year Development Plan: On the heels of Mubarak's statement, the GOE introduced a new five-year economic and social development plan that calls for investment of LE 150 billion (\$26 billion) in FY2007/08, with annual increases to LE 850 billion (\$147 billion) by 2012. The plan, drafted by the new Ministry of Economic Planning, targets 8% growth in the first year. The government will focus on developing infrastructure that improves the investment climate, while the private sector will be encouraged to take a greater role in project finance. The plan prioritizes completion of projects begun under the previous five-year plan. In accordance with Mubarak's directives, the plan focuses on Upper Egypt, particularly water, sewage, road construction, and agriculture and land reclamation projects.

15. Public Sector Debts: In mid-December, Minister of Finance Boutros Ghali (YBG) announced a plan to use LE 9.2 billion (\$1.6 billion) of the proceeds from sale of the Bank of Alexandria (BOA) to settle the debts of 54 state-owned enterprises (SOE). The funds will be used to settle the bad debts, owed mostly to state banks, of certain petrochemical, textile, food, mineral and construction companies. This is the second round of SOE debt settlements, the first occurring earlier in 2006, when the government paid LE 6.9 billion (\$1.2 billion) to settle BOA's debts and LE 1.6 billion (\$278 million) to settle the debts of other SOEs to other state-owned banks. This second round of settlements will reduce the total SOE debts to state and private banks to LE 9.8 billion (\$1.7 billion), down from LE 31.5 billion (\$5.4 billion) in June 2004, when the current banking reform process began.

16. State-owned Bank Merger: Banque Misr's takeover of Banque du Caire was finalized in mid-February, according to Banque Misr's Chairman Mohamed Barakat. The two state-owned banks will soon release their financial statements for the second half of 2006, and then hold a joint annual general meeting. Barakat added that the government intends in 2007 to use the LE 9.2 billion in para 5 to settle the remaining non-performing loans of SOEs to both Banque Misr and Banque du Caire.

17. Wages: A study by Egypt's National Planning Institute revealed that, from 2001 to 2005, average wages declined, mainly due to decreases in farmers' income, the main source of employment in Egypt. Although farming accounts for 27% of Egypt's GDP, farmers receive less than 8% of total wages. Moreover, despite efforts to shift the economy from the public to private sector, in 2006 the GOE paid 30% of all wages.

18. Consumer Confidence: In line with the poor outlook for wages, consumer confidence in Egypt slipped in the second half of 2006. Despite the decrease, however, Egypt has the fourth highest level of consumer confidence in the Middle East, according to a MasterCard survey. Egypt stood at 78.2 points on the index's 100-point scale, down from 83 points in the first half of 2006, its highest point since 2004. The index consists of questions on five variables: unemployment, economic growth, income, the stock market and standard of living. Any score above 50 indicates positive consumer confidence. The index, which has a standard of error of less than 3%, is used by international corporations, including MasterCard, to help make investment foreign investment decisions.

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LEGISLATION  
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19. Capital Market Law Amendments: In February, Minister of Investment Mohieldin issued amendments to the executive regulations of the Capital Market Law No. 95 of 1992 regarding purchasing of controlling shares in joint stock companies. Under the new rules, an investor may not purchase more than a third of a company's total capital or voting rights through the stock exchange or other market mechanisms. Any investor seeking more than one-third of a company must bid on all outstanding shares of the company and convertible bonds. The new rule is designed to reflect international standards and best practices and aims to improve disclosure and bidding valuations to protect minority shareholder rights. The investor must have an independent financial adviser if the bidding price is less than the average market price over the previous six months, if shares are swapped or if the investor buys from a shareholder who holds more than 25% of the company's capital.

¶10. Securitization Rules: The Ministry of Investment also amended the executive regulations of the Investment Incentives Law to make it easier for companies to raise short-term capital through securitization. The amendments designate securitization as a non-banking financial service and allow the minimum capital requirement of securitization companies to be set in any convertible currency, and the capital to be deposited at any of the commercial banks registered with the Central Bank of Egypt. The new rules require that 50% of companies' capital be deposited in the convertible currency. Financial statements must be reported in the same currency as the company's capital. Securitization allows companies to discount their short-term debt, which increases cash flow and improves efficiency.

¶11. Property Tax Law: A new draft property tax law, which would lower property taxes from 46% to 10% of the rental value of a home, has been approved by the government and submitted to parliament. The law proposes a flat annual tax on all properties including registered and unregistered limited-income housing communities and - as with the new income tax law - eliminates most exemptions in exchange for the lower tax rate. It does not, however, eliminate partial exemptions currently applicable to limited-income housing and all units with a rental value of less than LE 150 per month. More than 80% of properties in Egypt are unregistered, according to Ministry of Finance (MOF) figures. MOF representatives believe the new tax law will create some incentive for property owners to rectify this problem.

¶12. Mortgage Finance: Amlak Finance, the UAE's biggest publicly traded Islamic mortgage company, is opening a mortgage financing unit in Egypt. Amlak, 45% owned by Emaar Properties, provides Islamic home, car and yacht finance to individuals. The new Egyptian office, Amlak Finance and Real Estate Investments, will be located in Cairo and will only offer Islamic real estate mortgages. Amlak officials are anticipating a dramatic growth in Egypt's real estate market with the introduction of legislation simplifying the registration of property. Establishing a mortgage market is a key GOE reform goal.

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Trade  
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¶13. QIZs CHINESE INDUSTRIAL ZONE: In January, the textiles committee at the Egyptian Federation of Commerce Chambers wrote Prime Minister Ahmad Nazif protesting against establishment of a Chinese industrial zone for readymade garments in the 10th of Ramadan City, east of Cairo. Committee members expressed fears that the new industrial zone would curb the chances for Egyptian investors to increase their exports to the U.S. as a result of price competition with Chinese products. The memo also highlighted concerns that Chinese textiles production would undercut Egyptian products in the domestic market and increase the employment of Chinese workers at the expense of Egyptians. Minister of Trade and Industry Rachid had approved the memorandum of understanding for the textile industrial zone with the Chinese government during his visit to China last year. According to data from the Ministry of Trade and Industry, joint venture investments with China in Egypt amounted to \$70.6 million as of March 2006.

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Telecommunications  
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¶14. In December, Google signed two agreements with the Ministry of Higher Education and the Ministry of Education enabling 3 million university students and 8 million preparatory students to use Google applications for email, instant-messaging, and calendar functions. Each student will receive 2 gigabytes of email storage. This is the first agreement of its kind in the region. Google CEO Eric Schmidt visited Cairo for the signing of the agreements with the Egyptian ministries.

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Oil and Petrochemicals  
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¶15. New Petroleum Investment Company: In December Minister of Petroleum Sameh Fahmi announced establishment of the Arab Company for Petroleum Investments -APICORP- under the umbrella of the Organization for Arab Oil Exporting Countries (OAOEC). The newly-established company will participate in financing hydrocarbon and petrochemicals projects in Egypt.

¶16. Natural Gas Investment: Also in December, Dourad, an Israeli energy company, announced it had concluded a \$2 billion contract for the import of Egyptian natural gas from the Egyptian - Israeli Joint venture company EMG. The contract spans 15-20 years, and Dourad will receive 1.2 billion cubic feet annually beginning in 2008 when the EMG pipeline is completed from Al Arish in Northern Sinai to Ashkelon on the Israeli Mediterranean coast.

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Water  
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¶17. In December, Egypt hosted the third regional conference on Arab Water, sponsored by the Arab Water Council (AWC). Egypt is currently AWC Chair. Minister of Public Works and Water Resources Mahmoud Abu Zaid discussed development of a common Arab vision for handling water shortages. Abu Zaid also encouraged enhanced cooperation with the World Water Council. The three-day conference brought together 350 scientists and international water experts to discuss the challenge of future water needs in the Arab world.

#### ----- ECONOMIC INDICATORS -----

#### ¶18. December - January

##### Exchange Rate:

	(12/27/06)	(01/31/06)		
Egyptian Pounds/\$	Buying	Selling	Buying	Selling
Avg. Bank/Bureau Rate	570.49	572.40	559.18	571.07

##### Capital Market:

	(12/28/06)	(01/31/07)	
CASE 30 Index		6,973	6,676
Hermes Financial Index	61,291		58,220
EFG Index	31,096	29,775	

##### Interest Rates:

(percent, monthly comparison)

Interbank Overnight	9.8 (12/26)	9.5 (12/30)
T-bills (182 days)	9.86(12/26)	9.67(12/30)
T-Bond (maturing 12/08)		10.86(12/25)
T-Bond (maturing 10/11)		no trade

##### Foreign Reserves:

(US \$ billion, official gov't figures)

(12/2006)	(01/2007)
26,045	26,089.4

##### Inflation

	(12/2006)	(01/2007)
Consumer Price Index (CPI)	12.4	N/A
(y-on-y)		

#### ¶19. January - February

##### Exchange Rate:

	(01/31/07)	(02/28/07)		
Egyptian Pounds/\$	Buying	Selling	Buying	Selling
Avg. Bank/Bureau Rate	569.18	571.07	569.02	570.83

##### Capital Market:

	(01/31/07)	
CASE 30 Index	6,676	7,165
Hermes Financial Index	58,220	62,987
EFG Index	29,775	32,170

##### Interest Rates:

(percent, monthly comparison)

Interbank Overnight	9.5 (12/30)	8.77
T-bills (182 days)	9.67(12/30)	8.45(02/27)
T-Bond (maturing 12/08)	10.86(12/25)	10.71(02/16)
T-Bond (maturing 10/11)	no trade	10.88

Foreign Reserves:

(US \$ billion, official gov't figures)

(01/2007)	(02/2007)
26,089.4	26,215.7

Inflation

	(01/2007)	(02/2007)
Consumer Price Index (CPI)	12.4%	N/A
(y-on-y)		

RICCIARDONE